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March 1, 2012

The Honorable Paul Ryan
Chairman
Committee on the Budget
207 Cannon House Office Building
Washington, DC 20515

Dear Mr. Chairman:

Last year's budget resolution provided the initial outlines of the Ways & Means Committee's agenda for tax reform. The Committee intends to build on the significant work it undertook over the last year to advance tax reform and believes that the Budget Resolution for Fiscal Year 2013 should reflect the progress that has been made and the work the Committee intends to undertake this year. Therefore, the Committee is expanding on the discussion of tax reform contained in the Budget Resolution for Fiscal Year 2012. The Committee is transmitting the attached paper as our recommendation for inclusion in the Budget Resolution for Fiscal Year 2013.

Sincerely,

DAVE CAMP
Chairman

cc: The Honorable John Boehner
The Honorable Eric Cantor

PRO-GROWTH TAX REFORM

The American tax system should be simple, efficient and fair to promote innovation and sustained job creation in the private sector. The current U.S. tax code fails on all these fronts. The system is notoriously complex, as individuals, families and employers spend over six billion hours and over $160 billion per year trying to negotiate a labyrinth of deductions and credits, a tangle of different rules for characterizing income, and a variety of schedules for taxing that income. Simply put, the code is too costly and too burdensome and is hindering job creation.

The U.S. tax system is highly inefficient, as tax considerations rather than economic fundamentals often distort individual decisions to work, save, and invest, which leads to slower economic growth. For example, on April 1, 2012, the United States will achieve the dubious distinction of having the highest corporate tax rate (federal and state combined) in the developed world – a factor that discourages employers and investors from locating in the United States. Furthermore, the United States has become an outlier in that it still uses a "worldwide" system of taxation. That system has not been substantially reformed in 50 years – when the United States accounted for half of global economic output and had no serious competitors around the world. This combination of the highest corporate tax rate with an antiquated "worldwide" system subjects American companies to double taxation when they attempt to compete with foreign companies in overseas markets and then reinvest their earnings in the United States.

The code is also patently unfair. It is littered with lobbyist loopholes that benefit narrow special interests. Washington should not be in the business of picking winners and losers based on which industry is politically popular or powerful. Nor should two families in similar circumstances pay very different tax bills based on which has the better accountant. A tax code that leads to such results violates the fundamental American principle of equal justice.

This budget starts with the proposition that first, Congress must do no harm. It assumes that Congress will not allow massive, across-the-board tax increases to hit the economy in 2013, when current law calls for the tax cuts that were first enacted in 2001 and 2003 to expire. And it assumes that Congress will not let the Alternative Minimum Tax (AMT) – originally designed to catch a handful of super-wealthy households who paid no federal income tax – ensnare tens of millions of middle-class American families. This budget then attacks all three of the problems described above with a set of fundamental reforms designed to lower tax rates, broaden the tax base, and reform the U.S. international tax rules, while getting rid of distortions, loopholes and preferences that divert economic resources from their most efficient uses.

Following the unveiling of these principles in last year's budget resolution, an overwhelming consensus has emerged that the country is in dire need of tax reform that lowers rates, broadens the tax base, and addresses global competitiveness. After three years, the Administration also has begun to recognize the need for tax reform. The outline for corporate tax reform released by the Administration in February, however,

falls woefully short: the rates are too high; the tax base is too narrow (and used as a tool to provide political favors); and the international reforms are anti-competitive.

By contrast, the principles of reform outlined in this budget ensure a simpler, fairer tax code not just for large corporations but for small businesses and American families as well. Unlike the Administration's plan, it improves the competitiveness of American workers and businesses in the global economy. Our trading partners have already reformed their tax systems to provide their companies with a competitive advantage. Competing in a 21st century global economy requires that we do the same.

Simplifying the Tax Code and Promoting Job Creation and Economic Growth

Major proposals

- **Reject the President's call to raise taxes.**
- **Consolidate the current six individual income tax brackets into just two brackets of 10 and 25 percent.**
- **Reduce the corporate rate to 25 percent.**
- **Repeal the Alternative Minimum Tax.**
- **Broaden the tax base to maintain revenue at the appropriate level designated by this budget resolution for the next ten years, and at a share of the economy consistent with historical norms of 18 to 19 percent in the following decades. These are levels compatible with growth, and – if the spending restraints in this budget are enacted – sufficient to fund government operations over time.**
- **Shift from a "worldwide" system of taxation to a "territorial" tax system that puts American companies and their workers on a level playing field with foreign competitors and ends the "lock-out effect" that discourages companies from bringing back foreign earnings to invest in the United States.**

In 1981, President Ronald Reagan inherited a stagnant economy and a tax code that featured 16 brackets, with a top rate of 70 percent. When he left office in 1989, the tax code had been simplified down to just three brackets, with a top rate of 28 percent. Reagan's tax reforms proved to be a cornerstone of the unprecedented economic boom that occurred in the decade during his presidency and continued in the decade that followed.

Over time, additional brackets, credits, carve-outs and lobbyist loopholes have undone the simpler and fairer tax code ushered in by the 1986 tax reform. In the last ten years alone, there have been nearly 4,500 changes made to the tax code. The current version for individuals has six brackets, with a top rate of 35 percent (which is set to climb to over 40 percent after the end of 2012, when hidden rates are considered). Individuals

react negatively toward the tax code partly because it is complex and attempts to steer them toward certain activities and away from others. In addition, there are always a few "surprises" that end up raising their tax bills. One such surprise – the Alternative Minimum Tax (AMT) – was initially designed to hit only the very highest-income taxpayers but now ensnares a growing number of middle-class households because of a flawed design.

The House plan affirmatively rejects President Obama's efforts to raise tax rates on small businesses and investors and to add new loopholes to the tax code for favored interests. Economic theory and analysis show that increasing marginal tax rates – tax increases that reduce incentives to work, save and invest that next dollar of income – reduces economic output. By contrast, reductions in marginal tax rates increase output, mainly by letting people keep more of each dollar they earn and thereby strengthening incentives to work, produce, and invest in the future. The House plan both realizes the job-promoting benefits of lower rates and ensures these reductions are revenue neutral through base broadening.

Unlike President Obama's proposal, the House plan would not penalize the nearly three quarters of America's small businesses that file taxes as individuals by imposing higher individual rates that make it harder for these vital enterprises to compete. As President Obama repeatedly says, small businesses have been responsible for two-thirds of the jobs created in the United States over the past 15 years, and almost 50 percent of small-business profits are taxed at the top two rates. Raising these rates means increasing taxes on the most successful job creators.

Raising taxes on capital is another idea that purports to affect the wealthy but actually hurts all participants in the economy. Mainstream economics, not to mention common sense, teaches that raising taxes on any activity generally results in less of it. Economics and common sense also teach that the size of a nation's capital stock – the pool of saved money available for investment and job creation – has an effect on employment, productivity, and wages. Tax reform should promote savings and investment because more savings and more investment mean a larger stock of capital available for job creation. That means more jobs, more productivity, and higher wages for all American workers.

The negative effects of high tax rates on work, savings and investment are compounded when a large mix of exemptions, deductions and credits are added to the system. These tax preferences are similar to government spending – instead of markets directing economic resources to their most efficient uses, the government directs resources to politically favored uses, creating a drag on economic growth and job creation.

In the worst cases, these tax subsidies literally take the form of spending through the tax code, because they take taxes paid by hardworking Americans and issue government checks to individuals and corporations who do not owe any taxes at all. In fact, President Obama's corporate tax "reform" framework would expand this practice by transferring taxes paid by middle class Americans to the pockets of politically favored industries.

Eliminating large tax subsidies would not be for the purpose of increasing total tax revenues. Instead, when offset by lower rates, it would have a doubly positive impact on the economy – it would stop diverting economic resources to less productive uses, while making possible the lower tax rates that provide greater incentives for economic growth.

President Reagan's tax reforms inaugurated an era of great prosperity. It is time to reclaim his legacy and once again enact a fundamental reform of the tax code as the final step in rebuilding the foundations for economic growth: spending restraint, reasonable and predictable regulations, sound money, and a simple tax code with low rates.

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